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Ferry corporation losing money, sells office building

~Patrick Brown

BC Ferries Services Inc has hit the financial wall.

The corporation only avoided its first annual loss, some $5 million, by selling its old office building for $9.3 million more than its book value, and leasing new premises.

Even with the sale of the building, the resulting net earnings for the 2010-2011 fiscal year were $3.8 million, just slightly more than the 2009-2010 fiscal year, when earnings were $3.4 million.

BCFS rationalizes that the new building makes it possible to put its administration all in one place, for increased efficiency.

The writing has been on that wall for the last three years, though. Until 2005, despite declining traffic, substantial fare increases kept gross revenues steadily increasing but operating expenses kept pace.

However, despite continuously increasing fares, earnings from operations peaked in 2005-2006 at $75 million, and the trend has been lower since, to $67 million in 2010-2011.

Debt Service Outstrips Earnings

Interest costs on the company's ever-increasing capital debt (now $1.3 billion) have risen rapidly from a low of $18 million in 2006-2007 to $72 million in 2010-2011.

In this past fiscal year, interest on debt exceeded, for the first time, earnings from operations. Hence the $5 million loss.

BC Ferry Services Inc Model

BCFS has followed the business framework set out in the *Coastal Ferry Act, 2003*, which set up BCFS as a privatized (but 100% provincially owned) corporation to provide ferry services under contract to the provincial Ministry of Transportation.

Under the contract, the Province pays an annual 'ferry service fee' to BCFS for a predetermined set of routes and scheduled services. The government has not increased this fee from the $92 million allocated in 2003.

BCFS finances the construction and maintenance of its ships and terminals, and pays its own operating expenses. It proposes fare levels for each four year 'performance term' to cover its costs; these fares are reviewed and authorized by an independent ferry commissioner.

The Ferry Commissioner's major responsibility is to ensure the solvency of the corporation, and thus its ability to finance its capital requirements. This approval system was also supposed to ensure that fares would rise at no more than the Consumer Price Index, and remain affordable for ferry users.

In order to ensure that fares did not rise to politically unacceptable levels on the main routes, the *Act* required that the traditional cross-subsidy from the main routes to the minor routes be discontinued.

The model ensured that ferry users pay for all cost increases. This was accomplished by essentially freezing the 'ferry service fee' under the contract.

The result of the 'privatization' was that BC Ferries' debt was no longer on the government's books, and that the total annual cost of the ferry system to the government could be limited.

The First Four Years

The 2003 business plan anticipated that operational costs would rise at the same rate as the Consumer Price Index, that traffic would increase steadily year after year, and that the corporation would make enough profit to finance the renewal of the fleet (which had previously been paid for out of the provincial capital budget).

It worked for the first four years. Net earnings did hold up, peaking at $50 million in 2005-2006, but only because fares (as recorded by the Ferry Commission's price cap chart) rose over 20% on the main routes and 40% on the minor routes (far more than the Consumer Price Index).

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Traffic peaked in 2004/05, held its own (but did not increase) until 2007/08, then experienced a steep decline. Currently, it is below 2002-2003 levels (before the *Coastal Ferry Act* was enacted). The plan isn't working any more.

Debt

Meanwhile, BCFS set out to renew the fleet with a combination of refits and new replacement vessels.

The corporation concentrated on the main route ships, with the biggest expenditure being on three 'Coastal' class ships, built in Germany in 2007 and intended to match the performance and capacity of the original 'C' class double-ended ships, built in BC around 1980.

The new ships were financed by the German government and were designed and built by a shipyard that had no experience with double-ended ferries; they have been criticized both for vibration and fuel consumption (their displacement is three times that of the BC-built 'C' class ferries).

As a result of all this building activity, plus significant work on major terminals, BCFS' long-term debt rose steeply to $1.3 billion in 2008-2009 and has remained at this level. This is a debt-equity ratio of 4.3:1, and it cannot be allowed to rise any further. Interest expense, as noted above, rose steeply to $72 million in 2010-2011.

Over the next few years, BCFS must continue to replace the aging minor routes fleet. This will lead to more debt and higher interest expense.

Price Sensitivity

Since 2005-2006, fares have continued to rise steadily, with occasional hiccups from fuel surcharges, which rise and fall depending on the price of fuel.

Currently, the Ferry Commission's chart shows that fares are nearly 150% of 2003 levels (not counting costs for reservations) on the main routes, and 180% of 2003 levels on the minor routes. These 'price caps' represent an average fare; the increases (for example in discounted commuter fares on minor routes) can range to over 200% of 2003 fare levels.

The Consumer Price Index has risen about 11% in the eight years since the 'privatization' of the ferries; the promise of affordable fares has clearly been broken.

With these increases, it is not surprising that Islanders—including Vancouver Islanders—travel less on the ferries, and that the minor route Ferry Advisory Committees complain that the high fares are changing the way of life on the Islands.

Over the years, BCFS has commissioned various studies of price sensitivity, but it does not appear that any of the plans and forecasts have taken into account the feedback loop of higher fares = less traffic = even higher fares. (A recent forecast of traffic growth for the next few years assumed no increase in fares! BCFS finally opted to forecast unchanged traffic levels for the next four years.)

Financing The Marine Highway

The Ferry Commissioner's preliminary decision on fare levels for Performance Term 3 (2012-2016) anticipated annual fare increases of 8.23% for minor and northern routes, and 4.15% for the main routes.

Recent legislation, authorizing the new Ferry Commissioner, Gordon Macatee, to review all aspects of the *Coastal Ferry Act,* has now set the April 2012 increase at 4.15% for all routes, at least until Macatee's review is completed. Subsequently, the government agreed to pay an additional $4-5 million to make up for the lost minor route revenue.

Thanks to Nelle Maxey for her assistance with figures.
See also Editorial, page 4. ✐

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